

Internal Revenue Service

Department of the Treasury
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PLR-114925-07

Date: July 20, 2007

X =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Trust 1 =

Trust 2 =

Trust 3 =

A =

Dear :

PLR-114925-07

This responds to a letter dated March 23, 2007, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code for an inadvertent termination of S election.

Facts

X elected to be taxed as an S corporation effective Date 1. On Date 2, Trust 1, Trust 2, and Trust 3 became shareholders of X. On Date 2, Trust 1, Trust 2, and Trust 3 were grantor trusts, treated as owned by A during A's lifetime, and were eligible S corporation shareholders under § 1361(c)(2)(A)(i). On Date 3, A died, and Trust 1, Trust 2, and Trust 3 became eligible shareholders pursuant to § 1361(c)(2)(A)(ii) for the two year period ending Date 4. Because no election was made to treat Trust 1, Trust 2, and Trust 3 as Electing Small Business Trusts (ESBT), on Date 5, Trust 1, Trust 2, and Trust 3 were ineligible shareholders. As a result, X's S corporation election terminated on Date 5.

X represents that there was no intent to terminate X's S corporation election and that the failure to file timely the ESBT elections for Trust 1, Trust 2, and Trust 3 was not motivated by tax avoidance or retroactive tax planning. X represents that Trust 1, Trust 2, and Trust 3 each comply with the requirements under § 1361(e), which defines an ESBT.

X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation.

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(c)(2)(A)(ii) and § 1.1361-1(h)(1)(ii) provide that, for purposes of § 1361(b)(1)(B), a trust that is described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and that continues in existence after such death is a permitted shareholder, but only for the two-year period beginning on the day of the deemed owner's death. Section 1.1361-1(h)(3)(i)(B) provides that if stock is held by a trust described in § 1.1361-1(h)(1)(ii), the estate of the deemed owner is generally treated as the shareholder as of the day of the deemed owner's death.

Section 1361(c)(2)(A)(v) states that an ESBT is a permissible shareholder of an S corporation.

Section 1361(e)(1) defines an ESBT, in part, as a trust if --

- (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in paragraph (2), (3), (4), or (5) of § 170(c), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary,
- (ii) no interest in such trust was acquired by purchase, and
- (iii) an election under this subsection applies to such trust.

Section 1361(e)(3) provides that an election to be an ESBT shall be made by the trustee. Any such election shall be applied to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361 (b) or to obtain shareholder consents, (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in ineffectiveness, steps were taken so that the corporation is once more a small business corporation, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the

circumstances resulting in the ineffectiveness, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the representations made and the information submitted, we conclude that X's S election terminated on Date 5 because the trustees of Trust 1, Trust 2, and Trust 3 failed to timely file and complete the required ESBT elections under section 1361(e)(3). We further conclude, however, that the termination was an inadvertent termination within the meaning of section 1362(f). Pursuant to the provisions of section 1362(f), X will be treated as continuing to be an S corporation on and after Date 5, unless X's S election is otherwise terminated under section 1362(d), provided that the respective trustee files an ESBT election with the appropriate service center within 60 days of the date of this letter effective Date 6 for Trust 1, Trust 2, and Trust 3 and, accordingly, that Trust 1, Trust 2, and Trust 3 file any amended returns that are necessary to comply with this ruling. A copy of this letter should be attached to the ESBT elections.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed on: (1) Whether X is otherwise eligible to be treated as an S corporation; and (2) Whether Trust 1, Trust 2, or Trust 3 are eligible ESBTs under section 1361(e).

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

David R. Haglund
Senior Technician Reviewer
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes